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JOHN F. DAVIS,

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1969.

No. 412

FRED W. WOODWARD and ELSIE M. WOODWARD, F. R. WOODWARD and M. JEANNE WOODWARD,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

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vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

Petitioners pray that a **Writ of Certiorari** issue to review the judgment of the United States Court of Appeals for the Eighth Circuit, entered in the above entitled case on May 2, 1969.

CITATIONS TO OPINIONS BELOW.

The opinion of the Tax Court of the United States, printed in **Appendix A** hereto, infra, p. A-1, is reported at 49 TC 377. The opinion of the Court of Appeals, printed in **Appendix B** hereto, infra, p. A-20, is reported at 410 F. 2d 313.

JURISDICTION.

The judgment of the Court of Appeals was entered on May 2, 1969. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED.

Are amounts paid by majority stockholders (Taxpayers) for attorneys', appraisers' and accountants' fees for services rendered in connection with a state court litigation, the primary purpose of which was the judicial determination of the real value of a dissenting shareholders' common stock, deductible, under the provisions of Section 212 of the Internal Revenue Code of 1954, as ordinary and necessary expenses paid for the production of income, or for the management, conservation, or maintenance of property held for the production of income?

OR

in the alternative

Are fees and costs paid by majority shareholders (Taxpayers) relative to an equitable action arising under a state appraisal statute wherein the only issue was the "real value" of the common stock owned by a dissenting shareholder—title to such stock not being at issue or in dispute—capital expenditures incurred in connection with the acquisition of the title to the stock owned by the dissenting shareholder and therefore nondeductible under the provisions of Section 263 of the Internal Revenue Code of 1954?

STATUTES INVOLVED.

The statutory provisions involved are Section 212 of the Internal Revenue Code of 1954, 26 U. S. C., Section 212, printed in **Appendid C** hereto, infra, p. A-37, and Sec-

tion 263 of the Internal Revenue Code of 1954, 26 U. S. C., Section 263, printed in **Appendix C** hereto, infra, p. A-37.

STATEMENT OF THE CASE.

The petitioners, Fred W. Woodward and Elsie M. Woodward, are husband and wife. The petitioners, F. R. Woodward and M. Jeanne Woodward, are husband and wife. All of the petitioners are residents of Dubuque, Iowa. Each couple filed a joint federal income tax return for calendar year 1963 with the District Director of Internal Revenue at Des Moines, Iowa.

The jurisdiction of the Tax Court of the United States, the court of first instance, was invoked as a result of the filing by the taxpayers, within the time permitted by Section 6213 of the Internal Revenue Code of 1954, 26 U. S. C., Section 6213, of petitions for the redetermination of their 1963 federal income tax.

The Telegraph-Herald was originally organized as a profit corporation under the laws of the State of Iowa in 1901. Its corporate existence was renewed in 1921 and in 1941 (*Appendix pp. 4 and 19). The corporation is engaged in publishing a daily newspaper, operating a commercial printing plant and operating a radio station in Dubuque, Iowa (*Appendix pp. 3 and 20).

Pursuant to the 1941 renewal of its charter the corporate existence of the Telegraph-Herald was extended for a twenty year period to November 1, 1961 (*Appendix pp. 4 and 19). Section 491.25 of the 1958 Code of Iowa, printed in Appendix F. hereto, infra, p. A-51, provides a statutory procedure for the renewal of a corporation existing for a term of years.

On May 24, 1960, at the direction of the President of the corporation, written notice was given to each of the

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* Appendix p. ... refers to Appendix filed in Court of Appeals.

common stock shareholders of the Telegraph-Herald of a special meeting of such shareholders to be held at the office of the corporation in Dubuque, Iowa on June 9, 1960, for the purpose of renewing the corporation's existence perpetually and placing certain restrictions upon the sale and transfer of its outstanding common stock (*Appendix p. 10).

The issued and outstanding common capital stock of the Telegraph-Herald, at all times pertinent, consisted of 1,200 shares of $100 par value common stock. The ownership of the shares of common stock of the Telegraph-Herald as shown by the books and records of the corporation on June 9, 1960, was as follows (*Appendix pp. 4 and 19), to-wit:

Common Stockholder	Number of Shares
Fred W. Woodward	398
F. R. Woodward	58
M. Jeanne Woodward	55
Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust and Savings Bank of Dubuque, Iowa, as Trustees of Fred W. Woodward Trust No. 1	200
Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust and Savings Bank of Dubuque, Iowa, as Trustees of Fred W. Woodward Trust No. 2	100
Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased	10
Margaret M. Quigley	379
Total number of shares of the common stock of the Telegraph-Herald issued and outstanding on June 9, 1960	1,200

At the special meeting of the common stock shareholders of the corporation held on June 9, 1960, at which all

1,200 shares of the outstanding $100 par value common stock were represented, a resolution proposing perpetual existence and renewal was submitted for adoption (*Appendix p. 12).

The proposed resolution was approved and adopted at said meeting by all common stock shareholders except Margaret M. Quigley, who voted all of her 379 shares of stock against the renewal and the adoption of the resolution (*Appendix p. 15).

A certificate for the renewal of the Telegraph-Herald's corporate charter was issued by the Secretary of State for the State of Iowa, on or about June 10, 1960 (*Appendix p. 5).

The Taxpayers having voted with the majority of the Stockholders for the renewal of the corporate charter of the Telegraph-Herald on June 9, 1960, were obligated and required by the terms and conditions of Section 491.25 of the 1958 Code of Iowa to purchase the dissenting shareholder's 379 shares of the common stock of the Telegraph-Herald at its "real value" (*Appendix p. 5). This duty of the majority stockholders to purchase the stock of the dissenting stockholder arose as of the date the vote for renewal was taken, June 9, 1960 (*Appendix pp. 22 and 24). The statute imposes no duty on the corporation, as such, to purchase the stock of the dissenting stockholder, and its purchase by the majority stockholders was neither a condition precedent to the renewal of the corporate charter nor a condition subsequent to the continued existence of the corporation (*Appendix pp. 5 and 26). The renewal of the corporate charter was effective upon the expiration of the existing charter (*Appendix pp. 5 and 26).

The dissenting stockholder, Margaret M. Quigley, and the affirmative voting stockholders were unable to agree as to the real value of her Telegraph-Herald stock (*Ap-

pendix pp. 18 and 24), and on the 9th day of February, 1962, the affirmative voting stockholders, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased, filed an equitable action (Petition, printed in Appendix G hereto, infra, p. A-53) in the District Court of Iowa in and for Dubuque County asking the Court to determine and fix the real value of the dissenting shareholders' 379 shares of the common stock of the Telegraph-Herald as of June 9, 1960, pursuant to Section 491.25 of the 1958 Code of Iowa (*Appendix p. 17). The trial Court, in a decision rendered on May 18, 1963, determined a real value of $1,750 per share, printed in Appendix H hereto, infra, p. A-56.

All parties appealed from the real value determination of the District Court of Iowa in and for Dubuque County, to the Iowa Supreme Court. In a decision filed on February 9, 1965 (*Appendix pp. 6 and 23), the Supreme Court of Iowa determined and fixed the real value of the dissenting shareholders' common stock of the Telegraph-Herald at $1,650 per share, **Woodward v. Quigley,** 257 Iowa 1077, 133 N. W. 2d 38 (1965). The affirmative voting shareholders were granted a rehearing. The Iowa Supreme Court, in a decision filed on June 30, 1965, modified its initial determination and held that the real value of such common stock was $1,620 per share, **Woodward v. Quigley,** 257 Iowa 1077, 136 N. W. 2d 280 (1965) (*Appendix p. 7).

The case of **Woodward v. Quigley** (*Apendix p. 16) was brought to determine the extent of the liability created by the vote for renewal of the corporate charter, a matter involving a purely private right between the majority and dissenting stockholders (*Appendix pp. 7, 23 and 24). The corporation was not a party thereto and the action did not involve its business operations (*Appendix pp. 16, 21 and 26). The majority stockholders recognized their obligation under the Iowa statute to

purchase the stock of the dissenting stockholder (*Appendix p. 24). Being unable to agree upon the "real value" of the stock in question, the primary, and, in fact, the only purpose of the litigation was to obtain a court determination of the real value of the stock (*Appendix pp. 18, 21 and 24). NEITHER A MONEY JUDGMENT NOR THE ENFORCEMENT OF A CONTRACT OR STATUTORY OBLIGATION WAS SOUGHT OR DETERMINED (*Appendix pp. 18, 21 and 24). Title to the stock was never in question (*Appendix pp. 3, 17, 19, 21 and 24). The Iowa appraisal statute, Section 491.25, under which the equitable action was instituted presupposes that the dissenting stockholders own the shares which the court is to evaluate (*Appendix p. 5). Legal title remained in the dissenting stockholder until, on July 16, 1965, the majority stockholders purchased the shares of stock owned by the dissenting stockholder, Margaret M. Quigley (*Appendix pp. 7 and 42).

During the taxable year 1963 the majority stockholders voting to extend the corporate existence of the Telegraph-Herald, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased, paid attorneys', accountants' and appraisers' fees, costs and disbursements in the total of $37,890.75 for services rendered in connection with the determination of the real value of the dissenting shareholder's, Margaret M. Quigley's stock (*Appendix p. 7).

The Taxpayers, for the taxable year 1963, deducted their proportionate share of the attorneys', accountants' and appraisers' fees, costs and disbursements from their respective adjusted gross incomes, as ordinary and necessary expenses paid for the management, conservation and maintenance of property held for the production of income pursuant to Section 212 of the Internal Revenue Code of 1954 (*Appendix p. 8, **Exhibit A** and **Exhibit B**).

The Commissioner of Internal Revenue disallowed the deductions with the explanation, contained in his Notices of Deficiency, that the amounts claimed "for 'Professional fees incurred in relation to income producing property' are not allowable because the fees represent capital expenditures incurred in connection with the acquisition of capital stock of a corporation, Telegraph-Herald, instead of deductible expenditures" (*Appendix p. 33).

REASONS FOR GRANTING THE WRIT.

1. The decision of the Court below in the instant case is directly in conflict with the decision of the Seventh Court of Appeals in **Hilton Hotels Corporation v. United States**, 410 F. 2d 194 (1969), and with the decision of the Ninth Court of Appeals in **Heller v. Commissioner**, 147 F. 2d 376, Cert. denied 325 U. S. 868 (1945).

Notwithstanding that the Court below concedes that the **Hilton Hotels Corporation** case has a . . . "similar fact situation" . . . it reaches a diametrically opposed result. The only justification advanced in the opinion by the Eighth Court of Appeals for its contrary decision is that the deduction in the **Hilton Hotels Corporation** case was allowed under Section 162 of the Internal Revenue Code of 1954 while Section 212 is involved in the **Woodward** case. In essence, the Court below held that the **Hilton Hotels Corporation** case was neither applicable nor pertinent to the **Woodward** case since the deduction claimed and allowed in the **Hilton Hotels Corporation** case was taken as a trade or business expense under Section 162. This distinction was abolished by this Court in **Trust of Bingham**, 325 U. S. 365 (1945), wherein it was held that Section 23 (a) (2) of the Internal Revenue Code of 1939 (the predecessor of Section 212 of the Internal Revenue Code of 1954) is comparable and in pari materia with Section 23 (a) (1) of the Internal Revenue Code of 1939

(the predecessor of Section 162 of the Internal Revenue Code of 1954). Accordingly, the rationale advanced by the Court below to justify its decision contrary to the **Hilton Hotels Corporation** case is in conflict with this Court's **Trust of Bingham** case.

The conflict between the two Courts of Appeal is irreconcilable relative to the application of the "Primary Purpose Test" to . . . "a similar fact situation". The Eighth Court of Appeals in the **Woodward** case having refused to apply the "Primary Purpose Test" and the Seventh Court of Appeals in the **Hilton Hotels Corporation** case having applied the Primary Purpose Test to determine the deductibility of the litigation expenses.

The **Hilton Hotels Corporation** case rests upon the rationale of **Smith Hotel Enterprises, Inc. v. Nelson,** 236 F. Supp. 303 (E. D. Wis. 1964). The **Smith Hotel Enterprises, Inc.** case is founded upon the logic and authority of the **Heller** case. All three cases involved litigation costs and expenses precipitated by a state appraisal statute. In the **Hilton Hotels Corporation** case and the **Smith Hotel Enterprises, Inc.** case the taxpayers were the so-called "purchasers" of the stock and in the **Heller** case the taxpayer was the so-called "seller" of the stock. Accordingly, no distinction is made by the Seventh Court of Appeals relative to whether the taxpayer is a so-called "purchaser" or a so-called "seller" in its determination of the deductibility of litigation costs and expenses arising under a state appraisal statute. The Court in the instant case does, however, make such a distinction in dismissing the **Heller** case as not pertinent to the **Woodward** factual situation.

In addition, the decision of the Court below in the instant case conflicts in principle with the decision of the Fifth Court of Appeals in **Naylor v. C. I. R.,** 203 F. 2d (1953).

2. Clearly the question presented is of importance in the administration of the federal income tax law as well as to the business community. Settlement of this question is plainly in the public interest, since it will undoubtedly arise in every merger, consolidation and renewal of a corporation. A stockholder of a corporation contemplating such action must decide in every instance whether to go along with such merger, etc., or whether to dissent to such action. If he does not go along with the merger, etc., he has the further problem of determining whether the "buy-out" proposal of the corporation is commensurate with the "fair value" of his stock. At this stage he seeks professional counsel, relative to the "fair value" of his stock, his legal rights and remedies. Are the fees thus far incurred deductible? If he decides that the "buy-out" offer is too low and a judicial determination of value follows . . . are the litigation costs and expenses thus incurred deductible or are they to be capitalized, e. g. added to the basis of his stock? It is submitted that in the Seventh Court of Appeals that such litigation costs and expenses are deductible, but that in the Eighth Court of Appeals they are not. The Petitioners herein, the Woodwards, live in Dubuque, Iowa, a state in the Eighth Court of Appeals. Across the Mississippi River is Illinois, a state in the Seventh Court of Appeals. It is suggested that the state of the law is now such that if they had lived in Illinois at the time of the judicial determination of the real value of their Telegraph-Herald stock in 1962 they could have deducted the litigation costs and expenses thus incurred.

3. The decision of the Court below is believed to be erroneous and the conflicting decisions of the Seventh Court of Appeals in **Hilton Hotels Corporation v. United States**, supra, and the Ninth Court of Appeals in **Heller v. Commissioner**, supra, correct. The Court in the instance case refuses to consider the **Hilton Hotels Corpora-**

tion case as pertinent to and applicable to the **Woodward** case because the **Hilton Hotels Corporation** case was decided pursuant to the terms and conditions of Section 162 and not Section 212. A cursory examination of the opinion of the Eighth Court of Appeals reveals that its principal judicial authority was the case of **Boulder Building Corporation v. United States,** 125 F. Supp. 512 (W. D. Okla. 1954), notwithstanding that such case involved the deductibility of litigation costs under the predecessor of Section 162. The court in the instance case to strengthen its untenable conclusion that the litigation costs and expenses incurred in connection with a state court litigation, the primary purpose of which was the judicial determination of the real value of a dissenting shareholder's common stock, are nondeductible states that such litigation costs . . . "were much like brokerage fees". The inexactitude of this analogy is obvious; e. g. a stockbroker sells or buys stock according to the orders of his customers . . . he creates a market . . . he does not appraise the securities as to their "fair value" . . . it is his function to execute, buy and sell orders, not to make a determination of "fair value."

For pertinent comments relative to the decision in the **Woodward** case see **Stempfel v. United States,** 69-1 USTC Par. 9238 (D. C. Middle D. Tenn. 1969), and **Vermont Bank and Trust Company v. United States,** 296 F. Supp. 682 (D. C. Vt. 1969), both of which involve comparable fact situations. Further, it is strenously urged that the Court below in the instance case erred in its interpretation of the Iowa law relative to the property rights of the majority shareholders (Petitioners) and the dissenting shareholder arising on June 9, 1960 pursuant to the terms and conditions of Section 491.25 of the 1958 Code of Iowa.

The Iowa property law applicable to the factual situation existing in the instance case is as follows; to-wit:

(1). That a contract of sale arose by operation of law as a result of the action taken on June 9, 1960 at the special meeting of the stockholders;

(2). That pursuant to the terms and conditions of Section 491.25 of the 1958 Code of Iowa the statutorily imposed contract of sale became effective and binding on the majority shareholders and the dissenting shareholder on June 9, 1960; and,

(3). That whatever interest, property right, ownership, title, etc., the majority shareholders acquired in and to the dissenting shareholder's stock was acquired on June 9, 1960, subject to the payment of the purchase price.

CONCLUSION.

For the foregoing reasons, this **Petition for a Writ of Certiorari** should be granted.

Respectfully submitted,

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APPENDIX—A.

OPINION OF THE TAX COURT OF THE UNITED STATES.

49 T. C. 377.

Filed January 23, 1968.

"Tietjens, Judge: These consolidated cases involve deficiencies determined by respondent for the calendar year 1963 as follows:

Docket No.	Petitioners	Deficiency
4363-65	Fred W. Woodward and Elsie M. Woodward	$9,433.29
4364-65	F. R. Woodward and M. Jeanne Woodward	3,122.59

The sole issue for decision is whether fees and costs paid in connection with litigation to determine the value of certain stock represented capital expenditures or deductible expenses. In docket No. 4363-65 petitioners claim an overpayment of $1,134.47. Certain concessions of the respondent may be given effect under Rule 50.

All the facts are stipulated and are so found.

Petitioners Fred W. Woodward and Elsie M. Woodward are husband and wife. Petitioners F. R. Woodward and M. Jeanne Woodward are husband and wife. F. R. Woodward is a son of Fred W. and Elsie M. Woodward. All of the petitioners are residents of Dubuque, Iowa. Each couple filed a joint Federal income tax return for the calendar year 1963 with the district director of internal revenue at Des Moines, Iowa.

The Telegraph-Herald is a profit corporation organized under the laws of the State of Iowa, and is engaged in publishing a daily newspaper, operating a commercial printing plant and a radio station in Dubuque.

On June 9, 1960, the Telegraph-Herald had 1,200 shares of common stock issued and outstanding. Ownership of such shares on that date was as follows:

Owner	Number of Shares
Fred W. Woodward	398
F. R. Woodward	58
M. Jeanne Woodward	55
Elsie M. Woodward, R. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank of Dubuque, Iowa, as Trustees of Fred W. Woodward Trust No. 1	200
Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank of Dubuque, Iowa, as Trustees of Fred W. Woodward Trust No. 2	100
Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased	10
Margaret M. Quigley	379
Total	1,200

The Telegraph-Herald was originally incorporated in 1901. Its corporate existence was renewed in 1921 and 1941. Under the 1941 renewal its corporate existence was extended 20 years to November 1, 1961. The common stockholders of the Telegraph-Herald held a special meeting on June 9, 1960, for the purpose of renewing and extending its corporate existence and to consider placing certain restrictions on its common stock. This meeting

was attended by all of the stockholders or their representatives, at which time a resolution was duly adopted by the holders of a majority of the stock extending the corporate existence of Telegraph-Herald perpetually.

A certificate for the renewal of the Telegraph-Herald's corporate charter was issued by the Secretary of State for the State of Iowa on or about June 10, 1960.

The Telegraph-Herald's 1,200 shares of common stock issued and outstanding were all voted in favor of the renewal of the corporate existence except the 379 shares owned by Margaret M. Quigley.

Section 491.25 of the Iowa Code, Annotated, provides as follows:

491.25 Renewal—procedure

Corporations existing for a period of years may be renewed from time to time for the same or shorter periods, or may be renewed to exist perpetually, upon compliance with the provisions of this section and other applicable statutes.

The right of renewal is vested in the stockholders and shall be exercised by a resolution thereof adopted at any regular meeting or at any special meeting called for that purpose. Such resolution must be adopted by a majority of all the votes cast at such meeting, or by such other vote as is authorized or required in the company's existing articles of incorporation.

If the renewal instrument in proper form and the necessary fees are tendered to the secretary of state for filing three months or less either prior or subsequent to the corporation's expiration date, such renewal shall take effect immediately upon the expiration of the corporation's previous period of existence, and in such case, the corporate existence shall be

considered as having been extended without interruption. If the renewal is filed more than three months before or after the expiration date, such renewal shall take effect upon the date such renewal with necessary fees is accepted and filed by the secretary of state; and in cases where filed more than three months after the expiration date, shall not be in legal effect a renewal unless the procedure provided for and the additional fees provided for in section 491.28 are fully complied with and paid.

In all cases of renewal, those stockholders voting for such renewal must purchase at its real value the stock voted against such renewal, and shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal, which purchase price shall bear interest at the rate of five percent per annum from the date of such renewal action until paid. As amended Acts 1955 (56 G. A.) ch. 229, § 1.

The majority stockholders voting to extend the corporate existence of the Telegraph-Herald, and Margaret M. Quigley were unable to agree upon the real value of the latter's stock. The majority stockholders, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, Deceased, on February 9, 1962, filed a Petition in Equity in the District Court of Iowa, in and for Dubuque County, asking the Court to determine and fix the real value of Margaret M. Quigley's stock. A decision was entered by the District Court on May 18, 1963, establishing a value of $1,750 per share. The District Court ordered that the costs be taxed 68% to the plaintiffs and 32% to the defendant. This decision was appealed by all parties to the Supreme Court of Iowa.

In the case of **Woodward v. Quigley**, 257 Iowa 1077, 133 N. W. 2d 28 (1965), the Supreme Court of Iowa determined

the real value of Margaret M. Quigley's shares to be $1,650 per share. On rehearing the Supreme Court of Iowa, in **Woodward v. Quigley**, 257 Iowa 1077, 136 N. W. 2d 280 (1965), determined the real value to be $1,620 per share. The Supreme Court ordered that the costs be taxed one-half to the defendant and one-half to the plaintiffs.

Subsequent to the entry of final judgment in **Woodward v. Quigley**, *supra*, the 379 shares of Telegraph-Herald stock owned by Margaret M. Quigley were purchased on July 16, 1965, by the majority stockholders voting to extend the corporate existence of the Telegraph-Herald, as follows:

Purchaser	Number of Shares Purchased
F. W. Woodward	184
F. R. Woodward	27
M. Jeanne Woodward	25
Trust No. 1	92
Trust No. 2	46
Estate of Ellen Murphy	5
Total	379

During the taxable year 1963 the majority stockholders voting to extend the corporate existence of the Telegraph-Herald, with the exception of Charles Murphy, Executor of the Estate of Ellen Murphy, deceased, paid attorneys', accountants' and appraisers' fees, costs and disbursements in the total amount of $37,890.75 for services rendered in connection with the determination of the real value of Margaret M. Quigley's stock as follows:

Description of Expense	Amount of Payment
Clewell, Cooney & Fuerste (Attorneys' Fees)	$17,224.14
American Appraisal Company	8,684.40
Ernst & Ernst (Accounting Fees)	5,485.00
Reporting Services	4,635.76
Miscellaneous	1,861.45
Total	$37,890.75

The proportionate share of the fees, costs and disbursements paid by Fred W. Woodward, during the taxable year 1963 was $20,072.23.

The proportionate share of the fees, costs and disbursements paid by F. R. Woodward and M. Jeanne Woodward during the taxable year 1963 was $5,931.51.

The respective petitioners claimed the above amounts as itemized deductions described as 'professional fees incurred in relation to income-producing property' on their returns for 1963.

The fees, costs and disbursements set forth above were reasonable in amount and were incurred in connection with the determination of the value of the Quigley stock, except for the amounts of $185 in the case of Fred W. and Elsie M. Woodward, and $85 in the case of F. R. and M. Jeanne Woodward, which amounts were paid for professional services in the preparation of various tax returns and are conceded to be deductible.

Respondent disallowed the deductions with the explanation that the amounts claimed 'for "Professional fees incurred in relation to income producing property" is not allowable because the fees represent capital expenditures incurred in connection with the acquisition of capital stock of a corporation, Telegraph Herald, instead of deductible expenditures.'

We think respondent was clearly correct in his disallowance.

Petitioners contend that the expenses of the litigation are deductible under section 212 of the Internal Revenue Code of 1954[1] (formerly section 23 (a) (2) of the 1939 Code), as ordinary and necessary expenses paid for the production of income, or for the management, conservation, or maintenance of property held for the production of income.

Respondent's position based on the deficiency notice is that the litigation expenses in question were capital expenditures incurred in connection with the acquisition of capital stock and are therefore nondeductible under the provisions of section 263 of the Internal Revenue Code of 1954[2] and section 1.263 (a)-2 (c) and (e)[3] of the Regula-

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[1] **Sec. 212. Expenses for Production of Income.**

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property for the production of income; or

* * * * * * * *

[2] PART IX—ITEMS NOT DEDUCTIBLE

* * * * * * * *

Section 263. Capital expenditures.

* * * * * * * *

Sec. 263. Capital Expenditures.

* * * * * * * *

(a) General Rule.—No deduction shall be allowed for—

* * * * * * * *

[3] Income Tax Regulations. Section 1.263 (a)-2 Examples of capital expenditures.

The following paragraphs of this section include examples of capital expenditures:

(c) The cost of defending or perfecting title to property.

* * * * * * * *

(e) Commissions paid in purchasing securities. * * *

tions promulgated thereunder, as well as section 1.212-1 (k) and (n)[4] of the Regulations.

Petitioners wanted to renew and extend the corporate existence of Telegraph-Herald. To reach this end they had to comply with the sections of the Iowa Code governing such a transaction. Those sections required petitioners in precise language to '**purchase** at its real value the stock voted against such renewal.' (Emphasis supplied.) That is what they did; petitioners purchased the stock; but since they were unable to agree on its "real value" with the non-voting stockholders, they litigated that question and incurred the expenditures which they seek to deduct. The value-setting litigation and its attendant expenses were directly tied to the stock purchase and the expenses were part of the cost of the stock. As such, the expenses were clearly capital expenditures. The fact that the purchase was motivated by a desire to extend the corporate life is immaterial. **Atzingen-Whitehouse Dairy, Inc.**, 36 T. C. 173, 183 (1961).

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[4] Income Tax Regulations. Section 1.212-1 Nontrade or nonbusiness expenses.

* * * * * * * *

(k) Expenses paid or incurred in defending or perfecting title to property, in recovering property (other than investment property and amounts of income which, if and when recovered, must be included in gross income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. * * *

* * * * * * * *

(n) Capital expenditures are not allowable as nontrade or nonbusiness expenses. The deduction of an item otherwise allowable under section 212 will not be disallowed simply because the taxpayer was entitled under subtitle A of the Code to treat such item as a capital expenditure, rather than to deduct it as an expense. For example, see section 266. Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in subtitle A of the Code, no deduction is allowable under section 212; and this is true regardless of whether any basis adjustment is allowed under any other provision of the Code.

Both parties argue extensively that the expenditures here involved were or were not made in defense or perfection of title to the stock and so were or were not capital expenditures. Petitioners also argue that the "primary purpose" of the litigation was to determine the real value of the shares of the dissenting stockholder and that title to such shares was not at issue or in dispute. These contentions are beside the point and simply cloud the real issue.

To summarize, petitioners found themselves in the position of having to buy the stock of a fellow shareholder. Litigation was necessary to settle the price of the stock. The expenses in question were incurred in that litigation and no other. The result was the purchase of shares of stock by a group of shareholders from another shareholder at the litigated price. For all the record shows, petitioners still own the shares they purchased. Acquisition costs of property are not deductible. **John S. Lucas, et ux. v. Commissioner**, ... F. 2d ... (C. A. 1, No. 2907, 12/8/67), affirming a Memorandum Opinion of this Court. The expenditures were capital in nature to be added to the cost of the shares and are not deductible. **Atzingen-Whitehouse Dairy, Inc.**, *supra*.[5]

Reviewed by the Court.

Decisions will be entered under Rule 50.

Bruce, J., dissenting: In my opinion the majority has erred in at least three important respects in determining

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[5] Petitioners rely heavily on **Walter S. Heller**, 2 T. C. 371, affd. 147 F. 2d 376, on this issue, under the so-called "Dobson rule." That case involved the other side of the coin, i. e., sellers' expenses rather than purchasers' outlays. We do not think it is necessarily applicable here. If further reading is desirable see "Non-Business Expenses Relating to Property," William T. Plumb, Jr., American University Tax Institute Lectures, Vol. 2, pp. 357-360 and 4A Mertens, Law of Federal Income Taxation, sec. 25A.14, p. 40.

that the litigation expenses in question were nondeductible capital expenditures.

First, the majority, although the only issue presented in the state court litigation out of which the expenses in question arose was the 'real value' of the stock owned by Margaret M. Quigley and title to such stock was not at issue or in dispute has failed to give effect to the **primary purpose test** which this and many other courts have recognized as controlling in the determination of the character of litigation expenses. The mere statement that such a question clouds the issue here presented is certainly not sufficient.

Secondly, the majority opinion is contrary to prior decisions of this and other courts, in particular, **Walter S. Heller**, 2 T. C. 371, affd. 147 F. 2d 376 (C. A. 9, 1945), certiorari denied 325 U. S. 868, and **Smith Hotel Enterprises, Inc. v. Nelson**, 236 F. Supp. 303 (D. C. Wisc., 1964), both of which involved state statutes similar to the Iowa statute involved herein. See also **Naylor v. Commissioner**, 203 F. 2d 346 (C. A. 5, 1953), reversing and remanding 17 T. C. 959. Both **Heller and Naylor**, *supra*, were followed by this Court in **Raymond K. Dykema**, a Memorandum Opinion dated April 28, 1953, remanded by the Court of Appeals for the Sixth Circuit only because of an inconsistency in the findings affecting a part of the expenses involved. The rationale of the **Naylor** case was also approved in a court reviewed opinion of this Court, **Otto C. Doering, Jr.**, 39 T. C. 647, 650, affirmed 335 F. 2d 738 (C. A. 2, 1964), on other grounds. Although sometimes criticized, apparently for factual reasons, neither **Heller** nor **Naylor** has ever been overruled. The distinction of the **Heller** case suggested in footnote 5 of the majority opinion is hardly a valid one. In my opinion it is immaterial whether the purchaser or the seller instituted the litigation in question. I see no reason for treating the purchaser different than the seller.

Thirdly, **Atzingen-Whitehouse Dairy, Inc.**, 36 T. C. 173, cited by the majority in support of its conclusion is clearly distinguishable on its facts. In that case there was no litigation of any character which might have required consideration of the **primary purpose test.** See **Naylor v. Commissioner,** *supra.* The only fees involved were those paid an attorney for attending conferences, preparing agreements and handling other details necessary to consummate the purchase by a corporation of the stock of two dissident stockholders. **Lucas v. Commissioner,** ... F. 2d ... (C. A. 1, Dec. 8, 1967), cited by the majority, is also factually distinguishable from the present case.

In my opinion, the litigation expenses incurred and paid by the petitioners in connection with the case of **Woodward v. Quigley,** 257 Iowa 1077, 133 N. W. 2d 38, on rehearing 136 N. W. 2d 280 (1965), were ordinary and necessary expenses paid for the management, conservation, or maintenance of property held for the production of income and as such, are deductible under the provisions of section 212 of the Internal Revenue Code of 1954.

Petitioners contend that **Woodward v. Quigley,** *supra,* out of which the litigation expenses in question arose, was an equitable action, the primary purpose of which was to determine the "real value" of the shares of stock owned by the dissenting stockholder, Margaret M. Quigley, and that the title to such stock was not at issue or in dispute.

As a general rule, the courts have consistently recognized that expenditures made in defense or perfection of title to capital assets are capital expenditures and are not deductible as ordinary and necessary expenses whether incurred in a trade or business or in connection with a nonbusiness transaction. **Spangler v. Commissioner,** 323 F. 2d 913 (C. A. 9, 1963), affirming a Memorandum Opinion of this Court; **Robert L. Wilson,** 37 T. C. 230, affd. per curiam 313 F. 2d 636 (C. A. 5, 1963); **Industrial Ag-**

gregate Company v. United States, 284 F. 2d 639 (C. A. 8, 1960). It has also been held that litigation or other expenses incurred in the acquisition of stock or other capital assets are capital expenditures constituting a part of the cost of property and are not deductible. See **Helvering v. Winmill**, 305 U. S. 79 (1938), involving brokers' purchase commissions; **Atzingen-Whitehouse Dairy, Inc.**, 36 T. C. 173 (1961), involving fees paid an attorney for attending conferences, preparing agreements and handling other details necessary to consummate the purchase by the corporation of the stock of two dissident stockholders; **Iowa Southern Utilities Company v. Commissioner**, 333 F. 2d 382 (C. A. 8, 1964), certiorari denied 379 U. S. 946, affirming a Memorandum Opinion of this Court, wherein it was held that attorneys' fees and expenses incurred in a successful stockholders' derivative action and directed to be paid by the corporation were related to the recovery of capital assets and were not deductible as "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" under section 162 (a) of the Internal Revenue Code of 1954; **Robert L. Wilson**, *supra*, which held that legal expenses paid by a widow in perfecting her dower interest in the decedent's property were capital expenditures, non-deductible under section 212 of the Internal Revenue Code of 1954.

At the same time, as was clearly pointed out by the Court of Appeals for the Eighth Circuit in **Industrial Aggregate Company v. United States**, *supra*, at p. 645, and in **Iowa Southern Utilities Company v. Commissioner**, *supra*, at pp. 385 and 386, the mere fact that title to property happens to be involved in litigation does not necessarily mean that the litigation expenses are not deductible. The test is that of **primary purpose**. In the **Industrial Aggregate Company** case, the Court stated:

> At the same time, ever since Kornhauser v. United States, 276 U. S. 145, 48 S. Ct. 219, 72 L. Ed. 505,

cases recognize that the mere fact that title to property happens to be involved in litigation does not necessarily mean that expenditures of that litigation are automatically rendered nondeductible by the regulation. An example is Levitt & Sons v. Nunan, 2 Cir., 142 F. 2d 795, 797. Practicality and substance are to be recognized. The test which appears to have been established is that of **primary purpose.** Thus, if the primary or sole purpose of the suit is to perfect or defend title, the expenditures are not deductible, Shipp v. Commissioner, 9 Cir., 217 F. 2d 401, 402; Lewis v. Commissioner, 2 Cir., 253 F. 2d 821, 827-828; Garrett v. Crenshaw, 4 Cir., 196 F. 2d 185, 187; Addison v. Commissioner, 8 Cir., supra, at page 523 of 177 F. 2d. On the other hand, even though title may be involved, if its defense or perfection is not the primary purpose of the litigation, the expenditures do not encounter the barrier of the regulation's standard and they may qualify instead as ordinary and necessary expenses. Rassenfoss v. Commissioner, 7 Cir., 158 F. 2d 764, 767-768; Sergievsky v. McNamara, D. C. S. D. N. Y., 135 F. Supp. 233, 237-238; Straub v. Granger, D. C. W. D. Pa., 143 F. Supp. 250, 254-255.[10] [Footnotes omitted.]

See also **Manufacturers Hanover Trust Co. v. United States,** 312 F. 2d 785, 789 (Ct. Cl., 1963).

As was noted by the Court of Appeals for the Eighth Circuit in **Industrial Aggregate Company v. United States,** *supra,* in footnote 10 at page 645, the line of demarkation is not always apparent and each case is to be examined and decided on its own facts.

Under section 491.25 of the Iowa Statutes, as interpreted by the Supreme Court of Iowa in **State v. Shellsburg Grain & Lumber Co.,** 243 Iowa 734, 53 N. W. 2d 143 (1952); **Terrell v. Ringgold County Mut. Telephone Co.,**

225 Iowa 994, 282 N. W. 702 (1938); and **Melsha v. Tribune Pub. Co.**, 243 Iowa 350, 51 N. W. 2d 425 (1952), the duty of the majority stockholders to purchase the stock of the dissenting stockholder arose as of the date the vote for renewal was taken. The statute imposed no duty on the corporation, as such, to purchase the stock of the dissenting stockholder, and its purchase by the majority stockholders was neither a condition precedent to the renewal of the corporate charter nor a condition subsequent to the continued existence of the corporation. The renewal of the corporate charter was effective upon the expiration of the existing charter. As held by the court in **State v. Shellsburg Grain & Lumber Co.**, *supra*, the extent and nature of the liability created by the vote for renewal of the corporate charter were matters of a purely private right between the two groups of stockholders to be determined in a proper proceeding.

The case of **Woodward v. Quigley**, *supra*, was brought to resolve such a purely private right between the majority and dissenting stockholders. The corporation was not a party thereto and the action did not involve its business operations. The stock which petitioners owned in Telegraph-Herald was held by them for investment purposes and the extension of the life of the corporation was necessary to the management, conservation, or maintenance of such property. The majority stockholders recognized their obligation under the Iowa statute to purchase the stock of the dissenting stockholder.[6] The

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[6] The first opinion of the Supreme Court of Iowa stated (133 N. W. 2d 38, 40):

> Plaintiffs recognize their obligation to purchase the stock under this statute, but the parties have been unable to agree on the "real value" of defendant's stock. This action was brought by the majority stockholders to secure a court determination of the "real value." The trial court established a value of $1,750 per share and both parties have appealed.

See also **Robbins v. Beatty**, 67 N. W. 2d 12 (Iowa, 1954).

majority stockholders were interested in minimizing the value of the stock whereas the dissenting stockholder was interested in a high valuation. Being unable to agree upon the "real value" of the stock in question, the primary, and, in fact, the only purpose of the litigation was to obtain a court determination of the real value of the stock. Neither a money judgment nor the enforcement of a contract or statutory obligation was sought or determined. Title to the stock was never in question, and was only incidentally involved.[7] Title remained in the dissenting stockholder until, on July 16, 1965, the majority stockholders purchased the shares of stock owned by the dissenting stockholder, Margaret M. Quigley. The amounts paid for such stock are not involved in this proceeding.

In my opinion the litigation expenses incurred and paid by petitioners in connection with the above-entitled action are deductible, under the provisions of section 212 of the Internal Revenue Code of 1954, in ordinary and necessary expenses paid for the production of income, or for the management, conservation, or maintenance of property held for the production of income. I would so hold.

The parties have cited three cases involving state statutes somewhat similar to the Iowa statute involved herein. Two of the cases cited by petitioners support the conclusion I have reached in this proceeding; one cited by respondent reached a different conclusion.

In **Walter S. Heller**, 2 T. C. 371, affd. 147 F. 2d 376 (C. A. 9, 1945), certiorari denied 325 U. S. 868, cited by

[7] This is further emphasized by the fact that, although the Iowa statute imposed an obligation on the majority stockholders to purchase the stock of the dissenting stockholder, there is nothing in the statute or in the decisions of the Iowa courts, which would have prevented the dissenting stockholder, if she had not been satisfied with the value found by the court, from withdrawing her objection to the renewal and retaining her stock. Thus, a sale of the stock might not have taken place.

petitioners, the issue was whether legal fees and expenses paid by a dissenting stockholder, in connection with litigation to determine the value and to enforce his rights to the cash value of his shares pursuant to a California statute providing that stockholders not consenting to a merger or consolidation were entitled to be paid such value, were deductible as expenses for the production or collection of income or in the management of property held for the production of income. This Court stated (p. 374):

> The attorney's fee paid by petitioner, while relating to a capital asset, bore a reasonable and proximate relation to the production or collection of income, and to the management of property held for that purpose. The litigation did not, as respondent urges, involve a defense by petitioner of his rights in, and his title to, the stock. The statute under which it was instituted pre-supposes that the 'dissenting stockholders' own the shares which they are seeking to have appraised. The litigation concerned the exercise by petitioner of his right to receive cash for his shares and the determination of the amount thereof, he not having approved the contemplated merger or consolidation and having taken the other steps required by the statute. As a result of that litigation the fair market value of his stock was determined and paid to him in 1938. The attorneys' fee in our judgment was paid for services rendered in connection with "the production or collection of income," and in connection with "the management * * * of property held for the production of income." Respondent therefore erred in disallowing the claimed deduction.

In **Smith Hotel Enterprises, Inc. v. Nelson**, 236 F. Supp. 303 (D. C. Wisc., 1964), also cited by the petitioners, the corporation agreed to sell substantially all its assets, and

under a Wisconsin statute was required to purchase the stock of dissenting stockholders. It paid legal and other professional expenses in litigation to determine the fair value of the shares. The District Court held the deduction of such expenses was proper as an ordinary and necessary business expense, citing **Heller**, *supra*. The Court disagreed with the contrary holding in **Boulder Building Corporation v. United States**, 125 F. Supp. 512 (D. C. Okla., 1954), stating (at p. 305):

> Counsel for the plaintiff urges that the decision in Boulder is unsound in that it disregards the fact that the taxpayer's obligation to purchase the dissenters' stock was an involuntary obligation. Under the Oklahoma statute, as well as under the Wisconsin statute, once the dissenters have demanded that the corporation purchase their shares at fair value, the corporation has no choice in the matter. After the demand has been made, the corporation's main concern is with keeping its liablity to a minimum. Plaintiff's argument is sound. Viewed in this light it appears that the primary purpose of the state litigation in the instant case was a determination of the fair value of the shares, and the involvement of title was incidental. The deduction made by the taxpayer was proper as an ordinary and necessary business expense.

In **Boulder Building Corporation v. United States**, *supra*, which is strongly relied upon by respondent, a majority of the stockholders of an Oklahoma corporation, in accordance with the provisions of an Oklahoma statute, authorized the board of directors to extend the then expiring corporate life of the company, to enlarge and amend its corporate powers and to change its name. A minority of the stockholders demanded that the corporation purchase the minority stock at fair value as provided by the statute, and, when the two factions were

unable to agree on the value of the stock, filed an action in the state district court to gain a judicial determination of the stock's value. In connection with this litigation the company paid certain appraisers' and attorneys' fees, which the Commissioner disallowed as ordinary and necessary business expense deductions. The United States District Court for the Western District of Oklahoma held that such expenditures 'cannot be deemed an expense arising out of ordinary business operation but must be considered an expenditure directly related to the acquisition of capital stock.'

It does not appear that the District Court was aware of, or considered the opinion of this Court (affirmed by the Ninth Circuit Court of Appeals) in the case of **Walter S. Heller**, *supra*, which reached a different conclusion on substantially analogous facts. Moreover, in my opinion, the decision in **Boulder Building Corporation** is not sound. Although stating that the "fundamental contest," the "paramount issue," the "sole question," the "fundamental issue" in the state court litigation was to determine the fair value of the stock held by the minority stockholders, the Court stated: "It cannot reasonably be argued that title to the stock was involved only incidentally." This conclusion, in my opinion, failed to give effect to the **primary purpose** test and was unsound. In any event, I think the facts in the present case require a different conclusion and would so hold.

Fay, J., dissenting: I agree with much that Judge Bruce says in his dissenting opinion. I believe the facts of this case are indistinguishable from those in **Walter S. Heller**, 2 T. C. 371 (1943), affd. 147 F. 2d 376 (C. A. 9, 1945). In the opinion in that case we said, at p. 374:

> The litigation concerned the exercise by petitioner of his right to receive cash for his shares and the

determination of the amount thereof, he not having approved the contemplated merger or consolidation and having taken the other steps required by the statute. As a result of that litigation the fair market value of his stock was determined and paid to him in 1938. The attorneys' fee in our judgment was paid for services rendered in connection with "the production or collection of income," and in connection with "the management * * * of property held for the production of income." Respondent therefore erred in disallowing the claimed deduction.

The majority has not seen fit to overrule **Heller**. I think it should govern the disposition of the present case."

APPENDIX—B.

OPINION OF UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

410 F. 2d 313.

Filed May 2, 1969.

Matthes, Circuit Judge.

This case is before us on petition to review the decision of the Tax Court sustaining the determination by the Commissioner of Internal Revenue of deficiencies in the petitioners' income taxes for the year 1963. 49 T. C. 377 (1968) (opinion by Judge Tietjens reviewed by the entire court, with Judge Bruce and Fay dissenting).

The deficiencies result from deductions of litigation expenses incurred in connection with the acquisition of shares of stock by the petitioners. The petitioners contend that these expenses were incurred for the conservation, management or maintenance of property held for the production of income and thus deductible under § 212 of the Internal Revenue Code of 1954 which provides:

> "In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—
>
> (1) for the production or collection of income;
>
> (2) for the management, conservation, or maintenance of property held for the production of income; . . . ."

The Commissioner, on the other hand, maintains that the expenses were capital expenditures under § 263 of the 1954 Code (hereinafter referred to as "§ 263") which must be added to the basis of the property rather than deducted from gross income. Section 263 provides:

"No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to—(exceptions, irrelevant to this case, omitted) . . .

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made . . ."

Together the petitioners owned a majority interest in the Telegraph Herald, an Iowa corporation. The charter of the corporation was due to expire in 1961. The stockholders met on June 9, 1960, and by majority vote adopted a resolution extending the corporate existence of Telegraph Herald perpetually. A certificate for the renewal of the corporate charter was issued by the Secretary of the State of Iowa shortly thereafter.

The only shareholder voting against renewal was Margaret M. Quigley, who owned 379 of the 1,200 shares issued and outstanding. Under the corporate laws of Iowa it was provided that:

"In all cases of renewal, those stockholders voting for such renewal must purchase at its real value the stock voted against such renewal, and shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal, which purchase price shall bear interest at the rate of five per cent per annum from the date of such renewal action until paid." Ia. Code § 491.25 (1958).

On February 9, 1962, all the majority stockholders, except one, joined in filing a petition in the District Court of Iowa, Dubuque County, seeking a determination of the real value of the Quigley stock. The value was determined

by the district court to be $1,750 per share. This figure was lowered by the Supreme Court of Iowa to $1,650 per share. **Woodward v. Quigley**, 257 Ia. 1077, 133 N. W. 2d 38 (1965). On rehearing, the value was further reduced to $1,620. **Woodward v. Quigley**, 257 Ia. 1077, 1104, 136 N. W. 2d 280 (1965). After the entry of final judgment in the case, the minority stockholders, on July 16, 1965, purchased the stock.

During 1963 petitioners paid attorneys', accountants' and appraisers' fees along with other costs of services rendered in connection with the determination of the value of Mrs. Quigley's stock. The respective taxpayers deducted their proportionate shares of these expenses on their income tax returns for 1963, describing them as "professional fees incurred in relation to income-producing property." The Commissioner disallowed the deductions "because the fees represent capital expenditures incurred in connection with the acquisition of capital stock of a corporation." The taxpayers timely filed petitions in the Tax Court for a redetermination of the deficiencies. As stated, the Tax Court upheld the Commissioner's action.

It has long been the government's view that the cost of defending or perfecting title to property is a capital expenditure. 26 C. F. R. § 1.263(a)—2(c) (1968).[1] The courts have accepted this view, 4A Mertens, Law of Fed. Income Taxation, §§ 25.24, 25A.16 (1966), but have added the restriction that not all expenses of litigation wherein title is involved are capital expenditures. If litigation arises concerning the title to property held by the tax-

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[1] 26 C. F. R., § 1.263 (a)—(2) provides:

"The following paragraphs of this section include examples of capital expenditures:

* * * * * * *

"(c) The cost of defending or perfecting title to property."

payer, the courts will look to the primary purpose of the litigation to determine the deductibility of litigation expenses.

> "Thus, if the primary or sole purpose of the suit is to perfect or defend title, the expenditures are not deductible. * * * On the other hand, even though title may be involved, if its defense or perfection is not the primary purpose of the litigation, the expenditures do not encounter the barrier of the regulation's standard and they may qualify instead as ordinary and necessary expenses. **Industrial Aggregate Co. v. United States**, 284 F. 2d 639, 645 (8th Cir. 1960) (citations omitted).

In the latter instance the expenses are currently deductible from gross income under section 162 or 212 of the Internal Revenue Code of 1954 (formerly § 23 (a) (1) and § 23 (a) (2), respectively of the Internal Revenue Code of 1939 and hereinafter referred to as "§ 162" and "§ 212").[2]

Petitioners would extend the primary purpose test to litigation expenses incurred in the **acquisition** of property. They take the position that since the purpose of the liti-

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[2] Section 162, as amended, provides:

"Trade or business expenses—(a)
In general. There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity." * * *

gation below was merely to value shares which the taxpayers were required by law to purchase—rather than to perfect, defend or acquire title—the expenditures were incurred for the management, conservation or maintenance of property held for the production of income, and thus deductible under § 212.

The Commissioner argues, and the Tax Court held, that the primary purpose doctrine has no application to litigation expenses directly connected with the acquisition of a capital asset. According to this view, that doctrine becomes operative only when, having acquired property, a taxpayer incurs expenditures to defend or perfect title thereto. Accepting this view of the matter, the Tax Court found that the "value-setting litigation and its attendant expenses were directly tied to the stock purchase and the expenses were part of the cost of the stock. As such, the expenses were clearly capital expenditures," under § 263 of the 1954 Code. 49 T. C. at 382.

Petitioners' reliance on the primary purpose test is misplaced. As we have mentinoned, that test developed from the uncertainty surrounding the effect of Treas. Reg. 1.263(a)—2(c), which gives as an example of a capital expenditure "the cost of defending or perfecting title to property." Rather, this case involves the cost of **acquisition** of property. We thus have no need to apply the primary purpose test, a test which would only be relevant to a situation where the taxpayer's ownership of or interest in a capital asset is challenged. This was the situation in **Industrial Aggregate Co. v. United States**, *supra*, where litigation expenses were incurred in connection with a dispute concerning leases which taxpayer had held for many years. In that case we applied the primary purpose test to find the litigation expenses deductible.

The test was also recognized in **Iowa Southern Util. Co. v. Commissioner**, 333 F. 2d 382 (8th Cir.), **cert. denied**, 379 U. S. 946 (1964). There, shareholders of the taxpayer

corporation brought a derivative action against the corporation's majority shareholders and former president and others, on the theory that they had secretly acquired properties at prices for less than those at which they turned them in to the taxpayer (corporation). The corporation was not allowed to deduct the litigation expenses as ordinary and necessary business expenses under § 162. While we recognized the primary purpose test in that opinion, we did not apply the test to the facts of that case. Instead, Judge Blackmun, in reaching the decision that the litigation expenses represented capital expenditures, relied on several factors to be discussed later. Apparently the court treated the expenses as incidental to the earlier purchase of the capital assets. See **Spangler v. Commissioner**, 323 F. 2d 913, 921 (9th Cir. 1963) and **Munson v. McGinnes**, 283 F. 2d 333 (3d Cir.), **cert. denied**, 364 U. S. 880 (1960).

Petitioners also suggest that they obtained equitable title to the stock on the date the shareholders voted against corporate renewal. They argue the purchase was subject only to valuation and payment of the purchase price. Based upon this premise, it is asserted that the expenses were not incurred to perfect title or to purchase and thus were not capital expenditures.

Iowa law does not support the taxpayer's premise. The only Iowa cases cited by petitioners are **Woodward v. Quigley**, *supra*; **Robbins v. Beatty**, 246 Ia. 80, 67 N. W. 2d 12 (1954); **State v. Shellsburg Grain and Lumber Co.**, 243 Ia. 734, 53 N. W. 2d 143 (1952); **Melsha v. Tribune Publishing Co.**, 243 Ia. 350, 51 N. W. 2d 425 (1952); and **Terrell v. Ringgold County Mut. Tel. Co.**, 225 Ia. 994, 282 N. W. 702 (1938). Even Judge Bruce in his dissent was unable to read into the above cases the rule espoused by the Petitioners. He stated:

> "There is nothing in the statute or in the decisions of the Iowa courts, which would have prevented the

dissenting stockholder, if she had not been satisfied with the value found by the court, from withdrawing her objection to the renewal and retaining her stock. Thus, a sale of the stock might not have taken place." 49 T. C. 377, 386 at n. 2 (1968).

Assuming arguendo the validity of petitioners' premise, however, the conclusion they reach does not follow. There are several cases concerning litigation expenses incurred by the holder of equitable title of property to **perfect** his legal title. See **Spangler v. Commissioner**, *supra*, at 920, notes 16, 17. The authorities differ on whether these costs are deductible expenses or capital expenditures. **Contrast Allen v. Selig**, 200 F. 2d 487 (5th Cir. 1952) (expenses deductible under predecessor to § 212) **with Garrett v. Crenshaw**, 196 F. 2d 185 (4th Cir. 1952) (capital expenditures). We need not choose one of these divergent views because those cases did not concern the **acquisition** of property. Rather, the taxpayers were seeking to obtain legal recognition of their title. This purpose was not connected with the original acquisition of the property. What we have here, however, is litigation directly connected with the purchase of property. The expenses were incurred to establish the value of the capital assets acquired and were much like brokerage fees. They were part of the cost of acquisition. **Davis v. Commissioner**, 151 F. 2d 441 (8th Cir. 1945), **cert. denied**, 327 U. S. 783 (1946). And **see Johnson & Co. v. United States**, 149 F. 2d 851 (2d Cir. 1945).

This case may best be viewed against the historical background of the provision under which the deduction is claimed. Prior to the 1942 amendments to the Internal Revenue Code of 1939, expenses incurred for the production of income which could not meet the strict standards of "business" expenses were not deductible from gross income. **Higgins v. Commissioner**, 312 U. S. 212 (1941); 4A Mertens, § 25A.01 (1966). To remedy this situation

Congress enacted § 23 (a) (2) of the Code.[3] Section 212 of the Internal Revenue Code of 1954, set forth above, adopted the essential provisions of § 23 (a) (2) (with additions not pertinent here).

After the passage of § 23 (a) (2) there was debate over what types of expenditures were deductible under the provision. 4A Mertens, § 25A.14, n. 55. **See** Nahstoll, Non-Trade and Non-Business Expense Deductions, 46 Mich. L. Rev. 1015, 1026 (1948). There was a feeling, which still prevails among some commentators, that the broad definition of a capital expenditure as distinguished from a business expense under § 23 (a) (1), the predecessor to § 162 of the 1954 Code, was inapplicable to expenses deductible under § 23 (a) (2). Brookes, Litigation Expenses and the Income Tax, 12 Tax L. Rev. 241, 251-63 (1957); McDonald, Deduction of Attorneys' Fees for Federal Income Tax Purposes, 103 U. Pa. L. Rev. 168, 184-89 (1954); Comment, Federal Income Tax Treatment of Attorneys' Fees, 40 Tex. L. Rev. 137, 146 (1961). However, it was determined that the two provisions were in *pari materia* **Trust of Bingham v. Commissioner**, 325 U. S. 365, 373 (1945); **Iowa Southern**, *supra*, at 386; **Munson v. McGinnes**, *supra*, at 336; **see McDonald v. Commissioner**, 323 U. S. 57, 62 (1944), and the rule evolved that expenses deductible under § 212 are subject to the same limitations as § 162 expenses except for the "non-business" aspect of the former. **Trust of Bingham**, *supra*, at 374-75; **McDonald v. Commissioner**, *supra*, at 62; **Lucas v. Commissioner**, 388 F. 2d 472, 474 (1st Cir. 1967); **Iowa Southern**, *supra*, at 386; **Spangler v. Commissioner**, *supra*, at 918; 4A Mertens, § 25A.04. In particular, capital expenditures are not deductible under § 212, just as they are not deductible under § 162. **Lucas**

[3] This provision allowed deductions for, "[I]n the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

v. Commissioner, *supra*, at 474; **Spangler v. Commissioner**, *supra*, at 918-19; **Munson v. McGinnes**, *supra*, at 335; 4A Mertens, § 25A.14.[4]

Setting aside for the moment consideration of the capital aspects of this transaction, it is difficult to comprehend how these expenses were incurred "for the management, conservation, or maintenance of property held for the production of income." What is the property conserved? Petitioners suggest that it was their cash; that is to say, the less money the petitioners had to pay for the stock the more money they would "conserve." This contention is wholly without substance. Section 212 was not designed to allow tax deductions for the preservation of one's net worth. To come within the scope of § 212, the petitioners are forced to argue that through the valuation proceedings they were conserving either (1) the shares of stock they held as majority shareholders, or (2) the shares of stock they were required to purchase. In our view neither theory is sound. The first is not persuasive, because under Iowa law the charter of the corporation was renewed upon affirmative action of the majority. Their interest in the corporation and the value of their shares remained unaffected. The second theory is, as we have seen, unsupported by Iowa law. Neither the statute nor the cases indicate that the petitioners became the actual owners of the stock until the purchase was consummated by payment of the value determined by the Supreme Court of Iowa.

The general rule is that expenses incurred in acquiring or disposing of property are capital expenditures. See, *e. g.*, **Lucas v. Commissioner**, *supra*, at 474; **Munson v. McGinnes**, *supra*, at 335; **Jones' Estate v. Commissioner**, 127 F. 2d 231, 232 (5th Cir. 1942). See also 4A Mertens,

[4] The opinions in both **Iowa Southern**, *supra*, and **Spangler v. Commissioner**, *supra*, contain excellent discussions of the history and scope of § 212.

§ 25A.15 and the cases there cited. The expenditures here fall within that category. They "related directly" to the acquisition of capital assets. **Iowa Southern**, *supra*, at 388. The property would never have been acquired had not the value been established and paid. As was stated in **Munson v. McGinnes**, *supra*, at 335, "if the problem is to reach mutually satisfactory or binding terms of sale . . . the question of capitalization must be faced." That is precisely the situation we have here. It is similar to that involved in **Ward v. Commissioner**, 224 F. 2d 547 (9th Cir. 1955), where the seller was required to capitalize attorneys' expenses incurred in getting a higher price for the property sold. And see **Johnson & Co. v. United States**, *supra*, where litigation expenses incurred in valuing condemned property, the title to which had already passed to the purchaser, were held to be capital expenditures.

We regard our conclusion as consistent with the reasoning and result of our **Iowa Southern** decision, *supra*. There the state court action "had to do with the excess of the purchase prices paid by the taxpayer for assets transferred to it." *Id.* at 388. Here the state action concerned the amount to be paid for assets to be received. In **Iowa Southern** we recognized, "purchase prices, incontrovertibly, are capital in character. . . . What we desired in the state action was an adjustment in the prices," and thus, "the fees and expenses incurred related directly to capital." Here the state action also concerned the amount to be paid for the capital asset and was thus "related directly" to capital.

Again in **Iowa Southern** "the transferred assets were non-cash in character and were basis properties." The same is true here. And the excess amounts received by the taxpayer in **Iowa Southern** "could logically be expected to have pertinency in the adjustment of basis."

Here the amount paid by the taxpayer has a logical pertinence to the adjustment of basis. In fact the amount paid, including acquisition expenses, is the basis.

Finally, we noted in **Iowa Southern** that it is the "origin of the liability" and "the kind of transaction out of which the obligation arose" that is crucial. While these phrases were originally spoken in another context, **United States v. Gilmore**, 372 U. S. 39, 47-48 (1963) and **Deputy v. DuPont**, 308 U. S. 488, 494, 496 (1940), we believe that the "kind of transaction" is important in the determination of whether an expense is currently deductible or must be capitalized. The transaction involved here was the purchase of capital assets. The valuation of those assets was vital to the purchase, and the litigation necessary for valuation was thus an integral part of the overall transaction.

Our attention is directed by the petitioners to several decisions involving problems similar to the one before us. It will be noted that some of these cases involve the seller's side of the transaction. While we do not express any opinion as to whether the outcome would differ were the seller involved in this case, we do recognize a distinguishing characteristic in the seller's position. Until the property is valued and the price is paid by the purchaser, the seller still owns the property. There is not the conceptual difficulty with the phrase, "property **held** for the production of income," that is present here.

The first case relied upon by the taxpayers is **Heller v. Commissioner**, 2 T. C. 371 (1943) **aff'd**, 147 F. 2d 376 (9th Cir.), **cert. denied**, 325 U. S. 868 (1945). There the taxpayer, a dissenting shareholder, demanded the cash value of his shares rather than the stock of another corporation in a corporate acquisition. He instituted litigation pursuant to the California corporation laws for appraisal of the stock. The litigation expenses were held deductible

by the seller under § 212 because they bore a reasonable and proximate relation to the production or collection of income and to the management of property held for that purpose.

In addition to involving the seller's side of the transaction, the **Heller** case was decided the year after the predecessor to § 212 was enacted and at a time when its scope was in doubt. Furthermore, the courts in reviewing the Tax Court's decision were bound by the then-prevailing rule of **Dobson v. Commissioner**, 320 U. S. 489 (1943). **Allied Chem. Corp. v. United States**, 305 F. 2d 433, n. 3 at 443 (Ct. Cl. 1962) (dissenting opinion). We also note that **Heller** has been impliedly criticized by the Ninth Circuit, **Spangler v. Commissioner**, *supra*, at 919-20 n. 15, and that the Commissioner in his brief suggests that it "runs counter to the mainstream of relevant decisions in this area."

The case of **Naylor v. Commissioner**, 203 F. 2d 346 (5th Cir. 1953), while not involving a corporate reorganization or renewal, presents a problem analogous to the one at hand. There the taxpayer gave an option to buy shares which he held, with the price based on the net asset value of the company at a certain date. The purchaser exercised the option to purchase the shares, but a dispute arose over the valuation. The taxpayer hired an attorney to negotiate with the purchaser concerning the value of the shares. The expenses incurred in connection with the valuation were held to be deductible under what is now § 212.

Again we note that the taxpayer was the seller in the **Naylor** case. Furthermore, that case involved a completed sale of shares by which both parties were bound. And the court treated the problem as one of the collection of income under § 212, not as one involving property held for the production of income. See **Allied Chem. Corp. v. United States**, *supra*, n. 3 at 443 (dissenting opinion).

Moreover, it is significant that this case was also impliedly criticized in **Spangler v. Commissioner**, *supra*, n. 15 at 919-20. See **Commissioner v. Doering**, 335 F. 2d 738, 741, 743 (2d Cir. 1964); 4A Mertens, § 25A.16 n. 69.

There are two recent federal district court cases with similar fact situations which appear to support the taxpayers' viewpoint. In **Smith Hotel Enterprises v. Nelson**, 236 F. Supp. 303 (E. D. Wisc. 1964), the majority of the stockholders of the corporate taxpayer agreed to sell the corporation's assets. The dissenting shareholders demanded the fair value of their stock as provided for by statute. Since no agreement on valuation of the shares could be reached, the minority shareholders petitioned for a determination of value by the court. Litigation expenses in connection with the valuation proceeding were held deductible under § 162 as business expenses. In **Hilton Hotels v. United States**, 285 F. Supp. 617 (N. D. Ill. 1968), **aff'd** ... F. 2d ... (Apr. 1969), the dissenting shareholders to a corporate merger had their shares valued in appraisal proceedings for purchase by the corporate taxpayer. The expenses of the purchasing corporation were held deductible under § 162 with the court placing heavy reliance on the **Smith Hotel** decision.

Both of these decisions found deductions under § 162, rather than under § 212, the provision involved here. The court in **Smith Hotel** applied the primary purpose test to reach its decision. For reasons previously given, we do not believe that test is applicable to our case. Moreover, the statute involved in **Hilton** specifically provided that upon objection to merger by a stockholder, his shares were deemed to have been required by the corporation. As we have seen, there is no such provision in the Iowa statutes regarding corporate renewal.

The better view regarding the tax consequences of the litigation expenses in these cases is expressed by the court

in **Boulder Bldg. Corp. v. United States**, 125 F. Supp. 512 (W. D. Okla. 1954), on facts essentially identical to the facts in this case. In **Boulder**, minority shareholders of the taxpayer corporation objected unsuccessfully to renewal of the corporation's charter. They demanded that the corporation purchase their shares at a fair value in accordance with the statutory provision. Disagreement over the value of the stock ensued, and the shareholders filed a suit for a declaration of the value. Expenses incurred by the corporation incident to these proceedings were sought to be deducted as business expenses under the predecessor to § 162 of the present Code. The court rejected this contention and found the expenses to be capital expenditures because they were incurred "in connection with the acquisition of stock." *Id.* at 515-16.

In summary, the transaction involved the purchase of capital assets. The valuation of those assets was vital to the purchase, and the litigation necessary for valuation was thus inextricably woven into the fabric of the overall transaction. Petitioners have the burden of clearly showing their right to the claimed deduction. **Interstate Transit Lines v. Commissioner**, 319 U. S. 590, 593 (1943); **Iowa Southern**, *supra*, at 385. They failed to discharge that burden.

The decision of the Tax Court is affirmed.

APPENDIX—C.

STATUTES.

Internal Revenue Code of 1939

"Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

(1) Trade or business expenses.—

(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. In the case of any sports program conducted for the benefit of the American National Red Cross, expenses described in section 22 (b) (16) (B) shall be allowable under this subparagraph only to the extent that such expenses exceed the amount ex-

cluded from gross income by section 22 (b)(16)."

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Note: Sec. 23(a)(1)(A) of 1939 IRC is comparable to Sec. 162(a) of 1954 IRC.

Internal Revenue Code of 1939

"Sec. 23 Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses.—

• • • • • • • •

(2) Non-trade or non-business expenses.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conversation, or maintenance of property held for the production of income."

• • • • • • • •

Note: Sec. 23(a)(2) of 1939 IRC is comparable to Sec. 212 of 1954 IRC.

Internal Revenue Code of 1939

"Sec. 24. Items Not Deductible.

(a) General Rule.—In computing net income no deduction shall in any case be allowed in respect of—

• • • • • • • •

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate, except expenditures for the development

of mines or deposits deductible under section 23(cc); . . ."

• • • • • • • •

Note: Sec. 24(a)(2) of 1939 IRC is comparable to Sec. 263(a)(1) and (2) of 1954 IRC.

Internal Revenue Code of 1954

"Sec. 162. Trade or Business Expenses.

(a) In General.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

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Note: Sec. 162(a) of 1954 IRC is comparable to Sec. 23(a)(1)(A) of 1939 IRC.

Internal Revenue Code of 1954.

"Sec. 212. Expenses for Production of Income.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax."

Note: Sec. 212 of 1954 IRC is comparable to Sec. 23(a)(2) of 1939 IRC.

Internal Revenue Code of 1954.

"Sec. 263. Capital Expenditures.

(a) General Rule.—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to—

(A) expenditures for the development of mines or deposits deductible under section 616,

(B) research and experimental expenditures deductible under section 174,

(C) soil and water conservation expenditures deductible under section 175,

(D) expenditures by farmers for fertilizer, etc., deductible under section 180, or

(E) expenditures by farmers for clearing land deductible under section 182.

(2) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made."

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Note: Sec. 263(a)(1) and (2) of 1954 IRC are comparable to Sec. 24(a) of 1939 IRC.

APPENDIX—D.

REGULATIONS.

Promulgated Pursuant to IRC of 1939.

"Sec. 39.24(a)-2 Capital Expenditures.

(a) Expenditures except non-depreciable mine development expenditures. Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. See section 23(1). Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense. Amounts to be assessed and paid under an agreement between bondholders or shareholders of a corporation to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. See Sec. 39.22(a)-16. An assessment paid by a shareholder of a national bank on account of his statutory liability is ordinarily not deductible but, subject to the provisions of the Internal Revenue Code, may in certain cases represent a loss. Expenses of the organization of a corporation, such as incorporation

fees, attorneys' and accountants' charges, are capital expenditures and not deductible from gross income. A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stock holdings in the subsidiary may not deduct amounts paid in carrying out this guaranty in computing its net income, but such payments may be added to the cost of its stock in the subsidiary."

* * * * * * * *

Promulgated Pursuant to IRC of 1954.

"Sec. 1.162-1 Business Expenses.

(a) In general. Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or a credit under provisions of law other than section 162."

* * * * * * * *

"Sec. 1.212-1. Non-Trade or Non-Business Expenses.

(a) **An expense may be deducted under section 212 only if—**

(1) **It has been paid or incurred by the taxpayer during the taxable year** (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) **for the management, conservation, or maintenance of property held for the production of such income,** or (iii) in connection with the determination, collection, or refund of any tax; and

(2) **It is an ordinary and necessary expense for any of the purposes stated in subparagraph (1) of this paragraph.**

(b) **The term 'income' for the purpose of section 212 includes not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years; and is not confined to recurring income but applies as well to gains from the disposition of property.** For example, if defaulted bonds, the interest from which if received would be includible in income, are purchased with the expectation of realizing capital gain on their resale, even though no current yield thereon is anticipated, ordinary and necessary expenses thereafter paid or incurred in connection with such bonds are deductible. Similarly, ordinary and necessary expenses paid or incurred in the management, conservation, or maintance of a building devoted to rental purposes are deductible notwithstanding that there is actually no income therefrom in the taxable year, and regardless of the manner in which or the purpose for which the property in question was acquired. **Expenses paid or incurred in managing, conserving, or maintaining property held for investment may be deductible under section 212 even though the property is not currently productive and there is no likelihood that the property will be sold at a profit or will otherwise be productive of income and even though the property is held merely to minimize a loss with respect thereto.**

* * * * * * * *

(d) **Expenses, to be deductible under section 212, must be 'ordinary and necessary'. Thus, such**

expenses must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(e) A deduction under section 212 is subject to the restrictions and limitations in part IX (section 261 and following), subchapter B, chapter 1 of the Code, relating to items not deductible. Thus, no deduction is allowable under section 212 for any amount allocable to the production or collection of one or more classes of income which are not includible in gross income, or for any amount allocable to the management, conservation, or maintenance of property held for the production of income which is not included in gross income. See section 265. Nor does section 212 allow the deduction of any expenses which are disallowed by any of the provisions of subtitle A of the Code, even though such expenses may be paid or incurred for one of the purposes specified in section 212.

• • • • • • • •

(k) Expenses paid or incurred in defending or perfecting title to property, in recovering property (other than investment property included in gross income), or in developing or improving property, constitute a part of the cost of the property and are not deductible expenses. Attorneys' fees paid in a suit to quiet title to lands are not deductible; but if the suit is also to collect accrued rents thereon, that portion of such fees is deductible which is properly allocable to the services rendered in collecting such rents. Expenses paid or incurred in protect-

ing or asserting one's right to property of a decedent as heir or legatee, or as beneficiary under a testamentary trust, are not deductible.

* * * * * * * *

(m) An expense (not otherwise deductible) paid or incurred by an individual in determining or contesting a liability asserted against him does not become deductible by reason of the fact that property held by him for the production of income may be required to be used or sold for the purpose of satisfying such liability.

(n) Capital expenditures are not allowable as non-trade or non-business expenses. The deduction of an item otherwise allowable under section 212 will not be disallowed simply because the taxpayer was entitled under subtitle A of the Code to treat such item as a capital expenditure, rather than to deduct it as an expense. For example, see section 266. Where, however, the item may properly be treated only as a capital expenditure or where it was properly so treated under an option granted in subtitle A of the Code, no deduction is allowable under section 212; and this is true regardless of whether any basis adjustment is allowed under any other provision of the Code."

* * * * * * * *

"Sec. 1.263 (a)-2 Examples of Capital Expenditures.

The following paragraphs of this section include examples of capital expenditures:

(a) The cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property hav-

ing a useful life substantially beyond the taxable year."

* * * * * * * *

"(c) The cost of defending or perfecting title to property."

* * * * * * * *

"(e) Commissions paid in purchasing securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense."

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APPENDIX—E.

LEGISLATIVE HISTORY.

Revenue Act of 1942: HOUSE REPORT No. 2333, 77th Congress, 2nd Session (1942); 1942-2 C. B. 372.

At page 410 of 1942-2 C. B.:

"6. Nontrade or Nonbusiness Deductions.

The existing law allows taxpayers to deduct expenses incurred in connection with a trade or business. Due partly to the inadequacy of the statute and partly to court decisions, nontrade or nonbusiness expenses are not deductible, although nontrade or nonbusiness income is fully subject to tax. The bill corrects this inequity by allowing all of the ordinary and necessary expenses paid or incurred for the production or collection of income or for the management, conservation or mainteance of property held for the production of income. Thus, whether or not the expense is in connection with the taxpayer's trade or business, if it is expended in the pursuit of income or in connection with property held for the production of income, it is allowable."

At pages 429 and 430 of 1942-2 C. B.:

"Section 118. Nontrade or Nonbusiness Deductions.

This amendment allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the production and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or

not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) for the management, conservation, or maintenance of property held for the production of income. **Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a) (2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term 'income' for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property. Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income.** The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade

or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. Section 24 (a) (5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a) (2) or otherwise, which is allowable to one or more cases of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts allowable under that section which are allocable to tax-exempt interest.

Expenses incurred by an administrator or executor in the administration of the estate of a decedent, such, for example, as expenses in securing the processes and orders of the court having jurisdiction over the probate of an estate, or in adjusting claims against the estate, or in distributing the remaining assets to the beneficiaries, are not deductible under this section. Ordinary and necessary expenses, however, which are paid or incurred during the taxable year by an administrator or an executor for the production or collection of income which must be reported by the estate for income tax purposes, may be claimed as deductions under this section notwithstanding that deductions therefor are allowable under section 812 (b) in computing the gross estate subject to the estate tax. Accordingly, subsection (c) of this section amends section 162 to provide that no deduction shall be allowed under section 23 (a) (2) in computing the net income of the estate for amounts for which there may have been or has already been allowed a deduction under section 812 (b) in computing the net estate of the decedent. The present amendment would not allow as a deduction under section 23 (a) (2) for income tax purposes any amount which is allowable under section 812 (b) as a deduction in computing the net estate of a decedent for estate tax purposes, unless the Commissioner receives a statement, filed within the time and in the manner and

form prescribed by him, to the effect that the amount in question has not been claimed or allowed as a deduction under section 812 (b) and that the right to have such items allowed at any time as a deduction under section 812 (b) is waived.

Subsection (d) of this section amends 23 (1) of the Internal Revenue Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for obsolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Internal Revenue Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior Revenue Act on the date of its enactment."

Revenue Act of 1942: SENATE REPORT No. 1631, 77th Congress, 2nd Session (1942); 1942-2 C. B. 504.

At page 570 of 1942-2 C. B.:

"Section 121. Non-Trade or Non-Business Deductions.

This section is the same as section 118 of the House bill, except that subsection (c) of that section has been omitted therefrom and now appears as section 163 and a clerical amendment has been made in subsection (b). The amendment made by this section allows a deduction for the ordinary and necessary expenses of an individual paid or incurred during the taxable year for the produc-

tion and collection of income, or for the management, conservation, or maintenance of property held by the taxpayer for the production of income, whether or not such expenses are paid or incurred in carrying on a trade or business, and also allows a deduction for the exhaustion and wear and tear (including a reasonable amount for obsolescence) on property held for the production of income, whether or not such property is used by the taxpayer in a trade or business.

For an expense to be deductible under this section, it must have been incurred either (1) for the production or collection of income, or (2) **for the management, conservation, or maintenance of property held for the production of income. Ordinary and necessary expenses so paid or incurred are deductible under section 23 (a) (2) even though they are not paid or incurred for the production or collection of income of the taxable year or for the management, conservation, or maintenance of property held for the production of such income. The term 'income' for this purpose comprehends not merely income of the taxable year but also income which the taxpayer has realized in a prior taxable year or may realize in subsequent taxable years, and is not confined to recurring income but applies as well to gain from the disposition of property.** Expenses incurred in managing or conserving property held for investment may be deductible under this provision even though there is no likelihood that the property will be sold at a profit or will otherwise be productive of income, and even though the property is held merely to minimize a loss with respect thereto. The expenses, however, of carrying on a transaction which does not constitute a trade or business of the taxpayer and is not carried on for the production of income or for the management, conservation, or maintenance of property, but which is carried on primarily as a sport, hobby, or recreation are not allowable as non-trade or non-business expenses.

Expenses, to be deductible under section 23 (a) (2), must be ordinary and necessary, which rule presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of income, or to the management, conservation, or maintenance of property held for that purpose.

A deduction under this section is subject, except for the requirement of being incurred in connection with a trade or business, to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. Section 24 (a) (5), as amended by this section, while continuing to disallow any amount allowable as a deduction, whether under section 23 (a) (2) or otherwise, which is allocable to one or more classes of tax-exempt income, other than interest, has the effect in addition of disallowing a deduction under section 23 (a) (2) for amounts allowable under that section which are allocable to tax-exempt interest.

Subsection (c) of this section amends section 23 (1) of the Code so as to allow, in addition to the deduction allowable under the existing law, a deduction for the exhaustion, wear, and tear of property held by the taxpayer for the production of income, whether or not the property in question is used in the trade or business of the taxpayer, including a reasonable allowance for absolescence. Except for this, the new allowance is subject to the same limitations and restrictions which have been applicable under this section prior to the present amendment.

The amendments made to the Code by this section are applicable to all taxable years beginning after December 31, 1938. These amendments shall also be effective as if they were a part of the Revenue Act of 1938 or any prior Revenue Act on the date of its enactment."

APPENDIX—F.

IOWA APPRAISAL STATUTE.

Section 491.25 of the Iowa Code Annotated provides as follows:

"491.25 Renewal—procedure

'Corporations existing for a period of years may be renewed from time to time for the same or shorter periods, or may be renewed to exist perpetually, upon compliance with the provisions of this section and other applicable statutes.

'The right of renewal is vested in the stockholders and shall be exercised by a resolution thereof adopted at any regular meeting or at any special meeting called for that purpose. Such resolution must be adopted by a majority of all the votes cast at such meeting, or by such other vote as is authorized or required in the company's existing articles of incorporation.

'If the renewal instrument in proper form and the necessary fees are tendered to the secretary of state for filing three months or less either prior or subsequent to the corporation's expiration date, such renewal shall take effect immediately upon the expiration of the corporation's previous period of existence, and in such case, the corporate existence shall be considered as having been extended without interruption. If the renewal is filed more than three months before or after the expiration date, such renewal shall take effect upon the date such renewal with necessary fees is accepted and filed by the secretary of state; and in cases where filed more than three months after the expiration date, shall not be in legal effect a renewal unless the procedure provided for and the

additional fees provided for in section 491.28 are fully complied with and paid.

'In all cases of renewal, those stockholders voting for such renewal must purchase at its real value the stock voted against such renewal, and shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal, which purchase price shall bear interest at the rate of five percent per annum from the date of such renewal action until paid. As amended Acts 1955 (56 G. A.) ch. 229, § 1.' "

APPENDIX—G.

"In the District Court of Iowa in and for Dubuque County.

F. W. Woodward, F. R. Woodward, M. Jeanne Woodward; and Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank, Dubuque, Iowa, Trustees of Fred W. Woodward Trust No. 1; and Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank, Dubuque, Iowa, Trustees of Fred W. Woodward Trust No. 2,

Plaintiffs,

v.

Margaret M. Quigley,

Defendant.

No. 80,257.

PETITION IN EQUITY.

Plaintiffs state:

Par. 1. That the Plaintiffs, F. W. Woodward, F. R. Woodward and M. Jeanne Woodward, are the owners of capital stock of Telegraph-Herald, an Iowa corporation, with its principal place of business in the City of Dubuque, Dubuque County Iowa, that the Plaintiffs, Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank, Dubuque, Iowa, an Iowa corporation, as Trustees of the Fred W. Woodward Trust No. 1, are the owners of

capital stock of said corporation; that the Plaintiffs, Elsie M. Woodward, F. Robert Woodward, M. Jeanne Woodward and American Trust & Savings Bank, Dubuque, Iowa, an Iowa corporation, as Trustees of the Fred W. Woodward Trust No. 2, are the owners of capital stock of said corporation.

That each and all of said Plaintiffs are residents of Dubuque County, Iowa.

Par. 2. That the Defendant Margaret M. Quigley is a resident of Dubuque County, Iowa, and an owner of capital stock in said corporation.

Par. 3. That as of June 9, 1960, the Plaintiffs and the Defendant were the owners of all of the outstanding capital stock of said corporation except for ten shares owned by the Estate of Ellen E. Murphy, deceased, of which Charles J. Murphy was the duly appointed, qualified and acting Executor.

Par. 4. That a special meeting of the stockholders of the corporation was held at its office in the City of Dubuque, Iowa, on June 9, 1960 at 10:00 o'clock A. M., due notice of which meeting had been given to all holders of capital stock of the corporation.

That all of the capital stockholders were present or represented at said meeting.

Par. 5. At said special meeting of the stockholders of said corporation a resolution was duly adopted by a vote of the majority of all of the outstanding capital stock of said corporation, renewing and extending perpetually its corporate existence.

Par. 6. That all of the capital stockholders except the Defendant voted to renew the Articles of Incorporation and the Defendant voted against renewal.

Par. 7. That Section 491.25 of the 1958 Code of Iowa provides as follows:

> 'In all cases of renewal, those stockholders voting for such renewal must purchase at its real value the stock voted against such renewal, and shall have three years from the date such action for renewal was taken in which to purchase and pay for the stock voting against such renewal, which purchase price shall bear interest at the rate of five percent per annum from the date of such renewal action until paid.'

Par. 8. That the Plaintiffs and Defendant have been unable to agree as to the real value of the Defendant's stock as of June 9, 1960, the day the renewal resolution was adopted.

Wherefore, Plaintiffs ask that the Court determine and fix the real value of the Defendant's Telegraph-Herald capital stock as of June 9, 1960, for costs and for such other and further relief as shall be just and equitable.

ROBT. W. CLEWELL and
M. M. COONEY,
Members of the Firm of
Clewell, Cooney & Fuerste,
705 Roshek Building,
Dubuque, Iowa,
Attorneys for Plaintiffs".

APPENDIX—H.

"In the District Court of Iowa in and for Dubuque County.

F. W. Woodward et al.
vs.
Margaret M. Quigley.
} Equity No. 80257.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND DECREE FIXING 'REAL VALUE.'

This case came on for trial on September 17th, 1962, the plaintiffs appearing by M. M. Cooney and Donald Cooney of the firm of Clewell, Cooney & Fuerste, and the defendant appearing by Francis J. O'Connor and E. Marshall Thomas of the firm of O'Connor, Thomas, McDermott & Wright, and the submission of evidence was completed on the 26th day of October 1962, Counsel having filed written briefs and arguments and the Court having heard oral arguments of counsel on April 30th and May 1st, 1963, and the Court now being fully advised hereby makes the following Findings of Fact, Conclusions of Law and Decree Fixing the 'Real Value' of defendant's stock of Telegraph-Herald as of June 9, 1960, as follows:

Findings of Fact.

1. Telegraph-Herald is an Iowa profit corporation and was originally incorporated in 1901. Its corporate existence was renewed in 1921 and 1941, and under the 1941 renewal its corporate existence was extended 20 years to November 1, 1961.

2. On June 9, 1960, the outstanding capital stock of Telegraph-Herald consisted of 1,200 shares of $100 par value common stock, which stock was owned by the following persons:

F. W. Woodward .....398 Shares
F. R. Woodward ..... 58 Shares
M. Jeanne Woodward ..... 55 Shares
Elsie M. Woodward, F. Robert Woodward M. Jeanne Woodward, and American Trust & Savings Bank, Dubuque, Iowa, Trustees of Fred W. Woodward Trust No. 1 .....200 Shares
Elsie M. Woodward, F. Robert Woodward M. Jeanne Woodward and American Trust & Savings Bank, Dubuque, Iowa, Trustees of Woodward Trust No. 2 ....100 Shares
Ellen Murphy, deceased, Charles J. Murphy, Executor ..... 10 Shares
Margaret M. Quigley, defendant .....379 Shares

3. At a special meeting of the stockholders of Telegraph-Herald, held on June 9, 1960, the Articles of Incorporation of Telegraph-Herald were amended to provide, among other matters, perpetual existence for said corporation. All of the outstanding stock of Telegraph-Herald was represented at such meeting in person or by proxy and was voted in favor of said amendments, except the 379 shares, owned by the defendant, Margaret M. Quigley, which were voted against the renewal of corporate existence.

4. On June 9, 1960, and for many years prior thereto, Telegraph-Herald owned and published the "Telegraph-Herald," a daily newspaper, published six days a week, Monday through Friday and on Sunday, and owned and operated radio station KDTH in Dubuque, Iowa, operating on AM frequency with 1 kilowatt power. On June 9, 1960, the Telegraph-Herald corporation was also the owner of all the oustanding common stock, consisting of 100 shares of $100 par value, of Visual Education Center, Inc., which was engaged in selling educational filmstrips and other educational material for publication in newspapers.

5. The plaintiffs are the persons listed in Findings of Fact No. 2, except the owners of the Murphy stock and the defendant, Margaret M. Quigley.

6. Plaintiff F. W. Woodward is and was at all times relevant hereto the President and Publisher of Telegraph-Herald. Plaintiff F. R. Woodward is the son of F. W. Woodward and is and was at all times relevant hereto the Secretary and Treasurer and General Manager of Telegraph-Herald. Plaintiff M. Jeanne Woodward is the wife of F. R. Woodward and plaintiff Elsie M. Woodward is the wife of F. W. Woodward. M. R. Kane is and was at all times relevant hereto the Vice President of Telegraph-Herald.

7. The Board of Directors of Telegraph-Herald in 1960 and for many years prior thereto was as follows: F. W. Woodward, F. R. Woodward, M. Jeanne Woodward, Elsie M. Woodward and M. R. Kane.

8. The defendant Margaret M. Quigley has never been an officer or director of Telegraph-Herald.

9. Margaret M. Quigley acquired her 379 shares of stock of Telegraph-Herald by bequest from her husband, Joseph C. Quigley, who died January 22, 1952.

10. On June 9, 1960, and for many years prior thereto the Telegraph-Herald newspaper was the only daily newspaper published in the City of Dubuque, or in the County of Dubuque, Iowa."

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"Conclusions of Law.

1. The Court has jurisdiction of the parties and the subject matter hereof.

2. This is an equitable proceeding to fix and determine the real value of defendant's 379 shares of stock in the

Telegraph-Herald corporation as of June 9, 1960, under section 491.25 Code of Iowa, said stock having been voted against renewal of the corporate charter on said date.

3. That plaintiffs (together with owner of 10 shares of Murphy stock) voted for the renewal of the corporate charter of Telegraph-Herald on June 9, 1960 and have the obligation to purchase defendant's 379 shares of stock of Telegraph-Herald at its 'real value' under Section 491.25 Code of Iowa plus interest thereon at the rate of 5% per annum from June 9, 1960 until paid.

4. 'Real Value' as used in Section 491.25 of the Code of Iowa, does not mean market value of the minority interest.

Robbins v. Beatty, 246 Iowa 80, 67 N. W. 2d 12 (1954).

Note: The authorities in other jurisdictions generally agree that the terms 'value,' 'actual value,' 'true,' 'fair' or 'real' value of minority stock in merger or consolidation cases do not mean market value of the minority interest.

Tri-Continental Corp. v. Battye, Del. Ch. 74 A. (2d) 71;
American General Corporation v. Camp, 171 Md. 629;
In Re Fulton, 257 N. Y. 487, 178 N. E. 766 (1921);
Petry v. Harwood Electric Co., 280 Pa. 142, 124 Atl. 302 (1924);
Republic Finance & Investment Company v. Fenster-Maker, 211 Ind. 251, 6 N. E. (2d) 541 (1937);
Roessler v. Security Savings & Loan Co., 72 N. E. (2d) 259 (1947).

5. 'Real Value' as used in Section 492.25 of the Code of Iowa, means intrinsic value, determined from a consideration of every relevant factor bearing upon the question of value.

6. In determining real value under Section 491.25 Code of Iowa, no reduction should be made on account of brokerage fees, flotation costs, or lack of marketability.

7. The real value of the 379 shares of stock of the Telegraph-Herald owned by defendant Margaret M. Quigley as of June 9, 1960, was $1,750.00 per share, or a total of $663,250.00.

8. The costs of this case are taxed to the parties as follows: 68% to plaintiffs and 32% to defendant.

Decree.

It is, therefore, Ordered, Adjudged and Decreed that the 'real value' of the 379 shares of common capital stock of Telegraph-Herald owned by the defendant, Margaret M. Quigley as of June 9, 1960, was $1,750.00 per share, or a total of $663,250.00 and the costs are taxed herein as follows: 68% to plaintiffs and 32% to the defendant.

Dated this 18th day of May, 1963.

By the Court:

EUGENE J. KEAN,
Judge,
Sixth Judicial District of Iowa."